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No. 88-1072

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In the Supreme Court of the United States

OCTOBER TERM, 1988

STATE OF TENNESSEE, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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Petitioners contend that Tennessee's local ad valorem property tax, as amended in 1986 by the addition of Tenn. Code Ann. § 67-5-203(c) (Supp. 1988), may be imposed on a private contractor's use of a federally owned munitions plant that is managed by the contractor for the government pursuant to a cost-plus contract. The court of appeals held that the tax asserted under Section 67-5-203(c) was not imposed on the contractor's beneficial use but was, in reality, imposed on the property of the United States and was therefore unconstitutional (Pet. App. 6a).

1. Since 1949, Holston Defense Corporation has contracted with the United States to manage the Holston Army Ammunition Plant, a federally owned facility located in Hawkins and Sullivan Counties, Tennessee (Pet. App. 2a, 9a). Under the contract, Holston produces

munitions exclusively for the United States, which assumes immediate title to the products without purchasing them. Holston does not hold title to, or a leasehold interest in, any government property. Holston's right of access to the plant is limited to performing its contractual duties; Holston does not perform work on behalf of itself or any other private entity. Holston's activities, moreover, are subject to strict government control and supervision. Pet. App. 9a. Holston procures the materials for carrying out the contract, using its own procedures and pledging its own credit, but title to the materials is transferred directly from the vendor to the United States. Holston is reimbursed for all allowable expenditures to carry out the contract, including taxes payable by Holston. Pet. App. 2a. In addition, Holston receives a negotiated yearly fee, which was $3.8 million for 1986 (Pet. App. 2a, 9a; C.A. App. 123).

Prior to the amendment of the tax statute at issue here, Hawkins County attempted to impose Tennessee's property tax on Holston on the theory that Holston held a taxable property interest in the plant. The United States sought a declaratory judgment that Holston had no property interest in the facility that could be subject to the property tax. A similar case was filed against Anderson County, Tennessee, in response to its attempt to impose the same real property tax against Union Carbide Corporation, another cost-plus management contractor for the United States. In each case, the district court rejected imposition of the tax, holding that the rights of Holston and Union Carbide under their contracts were not real property interests. Both decisions were affirmed by the Sixth Circuit based upon a decision of the Tennessee Supreme Court in *Union Carbide* v. *Alexander,* 679 S.W.2d 938, 940-942 (Tenn. 1984), which held that, while the interest of Union Carbide might be subject to a privi-

lege or use tax, it was not a real property interest taxable under Tennessee's ad valorem real property tax statute. *United States* v. *Anderson County, Tenn.*, 761 F.2d 1169, 1173-1174 (6th Cir. 1985), cert. denied, 474 U.S. 919 (1985); *United States* v. *Hawkins County, Tenn.*, 812 F.2d 1409 (6th Cir. 1987).

2. In 1986, Tennessee's legislature amended Tenn. Code Ann. § 67-5-203—which generally exempts federal, state, and local government property from Tennessee's property taxes—by adding subsection (c), which provides that all property of the United States used for other than an exclusively public purpose by any person not an agent or instrumentality of the United States will be taxed to such user at its property tax value minus a deduction for any restricted use.[1] Pursuant to the amended statute, Hawkins County assessed the tax at issue here for 1986 in the amount of $8,125,239.32 (Pet. App. 9a). The amount of the tax was calculated by the property assessor for Hawkins County by applying the statutory rate of assessment for industrial and commercial real property to the "current value" of the government property reduced by 40% to take account of contractual restrictions on Holston's use of the property. Pet. App. 4a.

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[1] Section 67-5-203(c) provides:

> All property of the United States or any department or agency thereof, leased or otherwise used for other than an exclusively public purpose by any person, not an agent or instrumentality of the United States, shall be assessed to such user of such property at its value as determined pursuant to § 67-5-601, subject only to a deduction for any restricted use. This subsection (c) shall not affect sales and use taxes imposed on users of federal property by § 67-6-209. The provisions of this subsection shall only apply to any county having a population in excess of forty-three thousand (43,000) according to the 1980 federal census or any subsequent federal census.

The United States filed suit in district court seeking declaratory and injunctive relief from the tax on a variety of grounds. The district court granted summary judgment for the government, holding that Holston was so closely interrelated with the United States that the purported use tax was, in reality, a tax on the underlying government property. Pet. App. 15a. The court of appeals affirmed (Pet. App. 1a-6a) on slightly different grounds. The court acknowledged (Pet. App. 5a) that Holston, as a cost-plus contractor for profit, was potentially subject to taxation for its beneficial use of the government-owned property. The court concluded (*ibid.*), however, that "Tenn. Code Ann. § 67-5-203(c) fairly cannot be said to impose a tax on Holston's beneficial use; instead, the statute describes an ad valorem tax on an interest in real property." The court noted (Pet. App. 6a) that the property was assessed "at forty percent of its value, pursuant to Tenn. Code Ann. § 67-5-801 (1983), which determines the classification and rate of assessment for real property. The value [the assessor] assigned to Holston in this instance," the court stressed (*ibid.*), "was the same one he had previously assigned to the company when the county had unsuccessfully contended that Holston held a leasehold interest and attempted to impose the ad valorem real property tax." The court accordingly concluded (*ibid.*) that the tax in question here was not a permissible tax on Holston's beneficial use of the property, but rather an impermissible tax on property wholly owned by the United States.

3. The court of appeals correctly held that the Tennessee statute as applied in this case taxed the federal government's property. The tax was therefore constitutionally impermissible. "[U]nshaken, rarely questioned * * * is the principle that possessions, institutions, and activities of the Federal Government itself in the absence of express congressional consent are not subject to any form of state

taxation." *United States* v. *County of Allegheny,* 322 U.S. 174, 177 (1944). See also *United States* v. *County of Fresno,* 429 U.S. 452, 459 (1977); *United States* v. *Tax Commission of Mississippi,* 421 U.S. 599, 612-613 (1975); *Department of Employment* v. *United States,* 385 U.S. 355, 358-359 (1966); *M'Culloch* v. *Maryland,* 17 U.S. (4 Wheat.) 316 (1819).

It is well established that a local tax may constitutionally be imposed upon the use by a private corporation of property owned by the United States and leased to the private party for use in its business, even where that business is exclusively devoted to providing goods or services to the United States. *United States* v. *County of Fresno,* 429 U.S. 452, 462-463 (1977); *United States* v. *City of Detroit,* 355 U.S. 466, 470 (1958); *United States* v. *Township of Muskegon,* 355 U.S. 484, 486 (1958). But it is equally clear that where a tax fails to identify, segregate and evaluate the private party's interest in the property owned by the federal government, and is based on a value exceeding the private party's interest in that property, the tax is on the federal government's property and violates the United States' immunity from local taxation. *United States* v. *County of Fresno,* 429 U.S. at 462-463 n.10; *United States* v. *County of Allegheny,* 322 U.S. at 186-187.

In *United States* v. *Colorado,* 627 F.2d 217, 221 (1980), aff'd *sub nom. Jefferson County, Colo.* v. *United States,* 450 U.S. 901 (1981), the Tenth Circuit struck down a tax similar to that at issue here that Colorado attempted to impose on a corporation operating a federally owned nuclear weapons plant pursuant to a management contract. Under the Colorado statute, if real property that was exempt from taxation was used by a corporation in connection with a business operated for profit, then the user of the property was subject to taxation as if it were the owner of the property. This Court affirmed the conclusion of the

Tenth Circuit that "the 'substance' of the present procedure is not to tax [the corporation's] 'use' of government owned property, but to lay an ad valorem general property tax on property owned by the United States."

Petitioners contend (Pet. 8, 11) that the Tennessee statute is distinguishable from the invalid Colorado statute because it segregates and measures "beneficial use" by deducting from the property's value any restrictions on its use. The court of appeals properly rejected this argument. Section 67-5-203(c) does not impose a tax on Holston's beneficial use but, instead, describes an ad valorem tax on the property of the United States. This section is found in Chapter 5 of Title 67 (Tenn. Stat. Ann.), which pertains only to property taxes. Privilege taxes are covered in Chapter 4 of Title 67, while sales and use taxes are covered in Chapter 6. Consistent with its placement in the chapter covering property taxes, Section 67-5-203(c) directs that the property shall be assessed to the user "at its value as determined pursuant to § 67-5-601", *i.e.*, at its property tax value, subject only to a deduction for restricted use. The tax remains on the property, albeit at a reduced value, not upon the beneficial use. Indeed, the statute specifies that it "shall not affect sales ~~and use~~ taxes imposed on users of federal property by § 67-6-209."

Thus, the statute at issue here, like that at issue in *United States* v. *Colorado, supra,* does not purport to be anything other than a tax on the property. Furthermore, it is clear that in this case Hawkins County is attempting to apply the statute to tax the federal government's property rather than Holston's beneficial use of that property. As the court of appeals explained (Pet. App. 6a), the assessor assessed the property to Holston according to ordinary procedures of the Tennessee code for "determin[ing] the classification and rate of assessment for real property." As

a result, "[t]he value he assigned to Holston in this instance was the same one he had previously assigned to the company when the county had unsuccessfully contended that Holston held a leasehold interest and attempted to impose the ad valorem real property tax." *Ibid.*

The court below did not, as petitioners suggest (Pet. 9, 10-11), hold that it is categorically impermissible to measure the value of beneficial use according to the value of the underlying property, subject to a deduction for restricted use. It merely held that the tax in question here was not imposed on, and limited to, Holston's beneficial use. The value of Holston's use of the plant obviously should not exceed its fixed management fee, which was $3.8 million in 1986. This is substantially less than the tax of $8,125,239 assessed against Holston for 1986. Since the tax itself therefore exceeds Holston's interest in the property, it is plain, as the court below concluded, that the tax is, in reality, a tax upon property of the United States.[2] In any event, such a factbound question concerning the application of settled legal principles to the specific tax imposed in this case does not warrant further review.[3]

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[2] The decision below is thus fully consistent with this Court's decisions in *United States* v. *City of Detroit*, 355 U.S. 466 (1958), and *United States* v. *Township of Muskegon*, 355 U.S. 484 (1958). In *City of Detroit* a federal contractor was the lessee of federal property and, thus, was held to have a taxable interest in the property. In *Muskegon*, the contractor was conducting a private commercial business selling goods to the United States and, while it did not have a formal lease, it essentially paid rent by reducing the price of the goods sold to the government to reflect the rental value of the property. Neither of these factors is present in the instant case.

[3] Because the courts below concluded that the tax in question was, in reality, a tax on the property of the United States, they did not reach the Government's additional arguments: (1) that the tax unconstitutionally discriminates against the United States, in that it does not similarly tax property owned by state and local governments or private

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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Acting Solicitor General

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tax-exempt entities that is used or managed by contractors, and (2) that the Holston ammunition plant is exempt from the tax under Section 67-5-203(c) because it is used exclusively for a public purpose. The judgment below could be supported on either ground.

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